(2)

90-1851

No. _____

Supreme Court, U.S.
FILED
MAY 29 1991
OFFICE OF THE CLERK

In the

Supreme Court of the United States

October Term, 1990

STEPHEN ADAMS,

Petitioner,

v.

RESOLUTION TRUST CORPORATION, as receiver for MIDWEST FEDERAL SAVINGS AND LOAN ASSOCIATION, HAROLD W. GREENWOOD, JR.; DONALD SNEDE; and JOHN DOES 1-10,

Respondents,

and

STEPHEN ADAMS,

Petitioner,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) as manager of the FSLIC RESOLUTION FUND,

Respondent.

APPENDIX
TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

TIMOTHY D. KELLY
JOHN E. GRZYBEK
3720 IDS Center
Minneapolis, Minnesota 55402
(612) 349-6171

Attorneys for Petitioner

May 29, 1991

1991 — Bachman Legal Printing, 835 Second Ave. So., Mpls., MN 55402 — (612) 339-8518
■ FAX 612-337-8053

APPENDICES

Page

Appendix A

The Court of Appeals Decision, Adams v. Resolution Trust Corp., et al., dated February 28, 1991..... 1a

Appendix B

The Court of Appeals Judgment, Adams v. Resolution Trust Corp., et al., dated February 28, 1991..... 29a

Appendix C

The Court of Appeals Decision, Northwest Racquet Swim & Health Clubs, Inc., v. Resolution Trust Corp., et al., dated February 28, 1991..... 31a

Appendix D

The District Court Decision, Adams v. Resolution Trust Corporation, dated February 9, 1990, as amended March 2, 1990..... 70a

Appendix E

The District Court Decision, Adams v. Federal Deposit Ins. Corp., dated February 23, 1990..... 98a

Appendix F

Statutes Relied Upon **Page**

I. 12 U.S.C. § 63 ..... 102a
II. 12 U.S.C. § 1441a 103a
III. 12 U.S.C. § 1729 ..... 105a

Regulations Relied Upon

I. 12 C.F.R. § 563.8-1 (1988) 107a
II. 12 C.F.R. § 563.13 (1989) 107a
III. 12 C.F.R. § 567.2(a) (1991) 108a

Appendix G

Transcript of Motion Proceedings Before The Honorable James M. Rosenbaum, United States District Court, dated August 24, 1989 ..... 109a

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 90-5123

Stephen Adams, *

*

Appellant, *

*

v. *

*

Resolution Trust Corporation as *
Receiver for Midwest Federal *
Savings and Loan Association; *
Harold W. Greenwood, Jr.; *
Donald Snede; and John *
Does 1-10, *

*

Appellees. *

No. 90-5124

Stephen Adams, *

*

Appellant, *

*

v. *

*

Federal Deposit Insurance *
Corporation (FDIC) as manager *
of the FSLIC Resolution Fund, *

*

Appellee. *

Appeals from the United States
District Court for the
District of Minnesota.

Submitted: September 12, 1990

Filed: February 28, 1991

Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

BRIGHT, Senior Circuit Judge.

Stephen Adams (Adams) appeals the district court's[1] grant of summary judgment[2] to the Resolution Trust Corporation (RTC) in this action for rescission of a subordinated debt securities agreement which Adams executed in conjunction with his purchase of $2.5

---

[1]The Honorable James M. Rosenbaum, United States District Judge for the District of Minnesota.

[2]The district court's decision is reported as Adams v. Resolution Trust Corp., 731 F. Supp. 352 (D. Minn. 1990).

million in subordinated debt securities from now insolvent Midwest Federal Savings and Loan Association (MWF). On appeal, Adams contends that MWF's insolvency does not affect his right to rescind the agreement by which MWF fraudulently induced him to purchase the securities. According to Adams, a post-insolvency rescission would elevate the subordinated debt to general creditor status, entitling him to set off the debt against a promissory note he executed in favor of MWF. Adams also contends that the district court should not have dismissed as moot his common law fraud claim against the RTC, in its capacity as receiver for MWF, merely because MWF possessed insufficient funds to satisfy a successful damages judgment. Finally, he contends that the district court erred in dismissing his related claim against

the Federal Deposit Insurance Corporation (FDIC) for violating ratable distribution principles in disposing of MWF's assets. We affirm.

I. BACKGROUND

This case arises out of the failure of the Minneapolis based Midwest Federal Savings and Loan Association (MWF) which we visited in Northwest Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp., Nos. 89-5526, 89-5585, slip op. (8th Cir. Feb. __, 1991) -- a companion case which we discuss below. Stephen Adams, a Florida businessman with interests in banking, broadcasting and publishing, purchased $2.5 million in subordinated debenture securities (Securities) from MWF on March 31, 1988. Adams financed the purchase with funds he borrowed on an apparently unsecured promissory note he executed in favor of

MWF at the time he purchased the Securities. On the same day, Adams executed a subordinated debt securities agreement (Securities Agreement) setting out the terms and conditions of the purchase.

The Securities Agreement expressly subordinated Adams's claims in the event of MWF's liquidation, "to all claims . . . against [MWF] having the same priority as savings account holders or any higher priority."[3] Joint Appendix (J.A.) 66. It also specified the remedies to apply in the event of default. The Securities

---

[3]The priority scheme governing claims against an insolvent thrift institution placed savings account holders in the sixth priority position after various administrative costs, expenses and debts associated with the operation of the receivership, various wage and benefits claims of the employees of the failed thrift, and certain government tax claims. 12 C.F.R. § 569c.11 (1989).

Agreement defined default as including failure to make timely payment of the principal or interest due, declaration of insolvency, or the appointment of a conservator, receiver or liquidating agent. A default would also arise in the event that "any representations or warranty made in writing by or on behalf of [MWF] herein or in connection with the transactions . . . shall prove to have been false or incorrect in any material respect on the date as of which made." J.A. 69.

In the event of a default, the remedies section provided that Adams could protect and enforce his rights by an action in law, suit in equity, or other appropriate proceeding. However, the Securities Agreement placed three significant limitations upon Adams' rights, powers and remedies. First, he could accelerate

payment in the event of default only to the extent that such payment did not leave MWF with insufficient capital to meet regulatory capital requirements set out in 12 C.F.R. § 563.13 (1988). Second, in the event that the Federal Savings and Loan Insurance Corporation (FSLIC) was appointed receiver of MWF, FSLIC would have no obligation to arrange for the assumption of the Securities. Finally, the Securities Agreement bound Adams to abide by the priority scheme set out in the Federal Home Loan Bank Board[4] (Bank Board) regulations governing the distribution of assets in liquidation

---

[4]The Federal Home Loan Bank Board acted as the principal regulator of the federal savings and loan industry until August 9, 1989, when Title IV of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 354, abolished the Bank Board and replaced it with the Office of Thrift Supervision.

proceedings.[5]

The sale of the Securities was contingent upon Bank Board approval pursuant to 12 C.F.R. § 563.8-1 (1988), governing the issuance of subordinated debt securities by federal savings and loan associations. By letter dated March 31, 1988, Donald Snede, MWF's chief financial officer, stated that the Bank Board had approved the issuance of the note. The Bank Board apparently had given prior approval, on December 21, 1987, to the sale and issuance of up to $25 million in MWF subordinated debt securities.

---

[5]Under the regulatory priority scheme, see note 4, the claims of subordinated debt holders like Adams held a ninth rank priority, behind the claims of all general creditors, and ahead only of equity interest holders. 12 C.F.R. § 569c.11 (1989).

MWF immediately applied the Securities to its regulatory capital.[6] From March 31, 1988 through November 1988, the Bank Board recognized the Securities as part of MWF's regulatory capital. In January 1989, however, the Bank Board issued a

---

[6]Regulatory capital is the sum of, inter alia, reserve accounts, retained earnings, permanent common stock, securities which constitute permanent equity capital, appraised equity capital and any other nonwithdrawable accounts which constitute the institutions reserves available for satisfying the claims of depositors and other account holders. See 12 C.F.R. § 561.13 (1988). Pursuant to statutory authority, 12 U.S.C. § 1464(s) (1988), the Bank Board, and its successor, the Office of Thrift Supervision (OTS), sets the minimum capital requirements for the industry. Since 1973, the Bank Board or OTS has permitted thrift institutions to include long-term subordinated debt securities as part of their regulatory capital because such securities possess many of the characteristics of permanent capital. 54 Fed. Reg. 34,148 (1989) (commentary accompanying Final Rule amendments to regulations governing the issuance and use of subordinated debt (codified at 12 C.F.R. § 563.13 (1989))); 12 C.F.R. § 561.13 (1988).

directive ordering MWF to prospectively remove the Securities from regulatory capital because Adams had purchased them with funds he had borrowed from MWF on an unsecured basis.

On February 13, 1989, the Bank Board declared MWF insolvent after finding that its obligations to its creditors (including savings account holders) exceeded its assets. Accordingly, the Bank Board exercised its statutory authority under 12 U.S.C. § 1464(d)(6)(A)(i) (1988), and named FSLIC as conservator of MWF. FSLIC attempted to operate MWF as a going concern.

On March 21, 1989, Adams filed the initial complaint against MWF and its officers which gave rise to this action. Adams brought claims for violations of federal and state securities laws, alleging that MWF had fraudulently

induced him to purchase the Securities by making material misrepresentations regarding its financial condition at the time of the transaction.[7] Adams asked the court to declare the Securities Agreement subordinating the investment rescinded and to set off the unpaid balance of the Securities obligation against a $7,485,000 promissory note

---

[7]Adams alleged that MWF and its officers did not disclose that one of its assets, which was carried on its books at over $100 million, was the subject of a legal dispute which brought its actual value into question. The dispute over the asset, currently the subject of litigation in federal court, brought into question at least $100 million of MWF's $140 million regulatory capital base, according to Adams. He asserted that MWF's nondisclosure and the resulting misrepresentations regarding its financial condition violated § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1988), § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771, and Minn. Stat. § 80A.01 (1986), and also constituted common law fraud and breach of contract.

which he owed to MWF.[8] He also sought damages for common law fraud.

Soon after, on April 7, 1989, MWF informed Adams that it would default on the 1989 first quarter interest payment due on the Securities. On May 4, 1989, the Bank Board, noting that MWF's liabilities continued to exceed its assets, concluded that MWF could not be operated as a going concern. The Bank Board, acting pursuant to statutory authority, 12 U.S.C. § 1464(d)(6)(A) (1988); 12 C.F.R. § 547 (1988), appointed FSLIC as receiver for the purpose of liquidating MWF. FSLIC, by operation of law, thus took possession of MWF and succeeded to all of MWF's rights, titles, powers and privileges. See 12 U.S.C. §§ 1464(d), 1729 (1988). In addition, the Bank Board determined that the total

---

[8]See note 3.

liquidation of MWF would not generate sufficient funds to satisfy the claims of MWF's general creditors. Therefore, it formally declared all subordinated debt and equity interests in MWF to be worthless.[9]

The Bank Board also contemporaneously created a new savings and loan association, Midwest Savings Association (Midwest Savings), to facilitate the liquidation of MWF and the reorganization of its assets. The Bank Board

---

[9]The settlement of claims in the event of liquidation proceeded under an absolute priority scheme, meaning that ninth and tenth priority subordinated debt and equity holders could receive treatment of their claims only after all claims of the first eight ranks had been fully settled. See 12 C.F.R. § 569c.11(d) (1989). Thus, the Bank Board's determination that MWF's assets were insufficient to satisfy the claims of seventh priority general creditors meant that no money remained for the claims of ninth priority subordinated debt holders like Adams.

immediately placed Midwest Savings under FSLIC conservatorship. It further directed FSLIC to enter into a purchase and assumption agreement with Midwest Savings, transferring most of MWF's assets to Midwest Savings in consideration for Midwest Savings, assumption of certain MWF liabilities.

Under the purchase and assumption agreement, Midwest Savings did not assume any MWF subordinated debt or equity liabilities or obligations, including the securities at issue here. As a result of this transaction, the obligations arising from the Securities remained with FSLIC, as receiver for MWF, while Midwest Savings assumed possession of the promissory notes against which Northwest sought to exercise its claimed right of setoff.

Adams responded to these regulatory actions by discontinuing payment on the promissory note now held by Midwest Savings. He also filed a second complaint, on June 28, 1989, against FSLIC in its corporate capacity, in which he contended that the purchase and assumption agreement violated ratable distribution principles implicit in the statutory provision governing the liquidation of failed thrifts, 12 U.S.C. § 1729 (1988). Adams contended that FSLIC should not have transferred Adams' $7,485,000 note to Midwest Savings because it knew that Adams sought to set it off against the Securities which FSLIC also knew MWF had fraudulently induced Adams to purchase. Adams contended that his rescission entitled him to share in the pro rata distribution of MWF's assets to the general creditors. Adams

consequently asked the court to declare the purchase and assumption agreement invalid and permit him to set off the Securities obligations against his MWF loan obligations now held by assignee Midwest Savings.

In February 1990, the district court granted FSLIC's motion for summary judgment in the first action. Adams v. Resolution Trust Corp., 731 F. Supp. 352 (D. Minn. 1990).[10] The district court adopted the analysis of the Second Circuit in In re Weis Sec., Inc., 605

---

[10]In August 1989, as part of the overhaul of the thrift industry embodied in the Financial Institutions Reform, Recovery and Enforcement Act, Congress abolished Federal Savings and Loan Insurance Corporation (FSLIC) and replaced it with the Resolution Trust Corporation (RTC). Pub. L. No. 101-73, Title IV, 103 Stat. 354 (1989). During the pendency of the proceedings before the district court, the parties accordingly stipulated to the substitution of RTC, for FSLIC, as receiver of MWF.

F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979), and held, as a matter of law, that because MWF had applied the funds from the sale of the Securities to regulatory capital, Adams was precluded from rescinding the Securities Agreement after the Bank Board had declared MWF insolvent. The Securities, therefore, remained subordinated, and thus lacked the requisite mutuality of obligation necessary to set them off against the promissory note.

The district court also dismissed as moot Adams' claim for common law fraud. The Bank Board's determination that Adams' subordinated debentures were worthless because MWF's assets were insufficient to satisfy general creditor liabilities meant, according to the district court, that FSLIC, as receiver,

simply had no assets with which to satisfy a judgment if Adams were to succeed on his common law fraud damages claim. Thus, the court dismissed the damages action on prudential grounds.

In a separate proceeding, the district court also dismissed Adams' second action against FSLIC seeking to invalidate the purchase and assumption agreement with Midwest Savings.[11] The district court again held that because Adams could not rescind the Securities Agreement, he remained a subordinated interest who had no right to participate in the pro rata distribution of assets to the general

---

[11]During the pendency of this action, Congress abolished FSLIC, in its corporate capacity, and replaced it with the Federal Deposit Insurance Corporation (FDIC). Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, Title IV, 103 Stat. 354. FDIC, accordingly, now stands in FSLIC's place as defendant and appellee in Adams, second filed action regarding the purchase and assumption agreement.

creditors.[12]

Adams filed this consolidated appeal.

II. DISCUSSION

All but one of Adams' contentions on appeal hinge upon the validity of the district court's determination that the application of his investment to MWF's regulatory capital precluded him from rescinding the Securities Agreement after the date of MWF's insolvency. We addressed this very issue in Northwest Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp., Nos. 89-5526, 89-5585, slip op. (8th Cir. Feb. __, 1991),

---

[12]For the same reasons, the district court also denied Adams, motion to preliminarily enjoin FSLIC from further transferring the assets of MWF and from enforcing the promissory note which Adams had ceased paying. Because Adams was not entitled to rescind the Securities Agreement, the Securities obligation remained subordinated to the higher priority promissory note of general creditor rank. Thus, Adams had no legal interest in the note which might justify enjoining its further transfer.

which was argued before this court on the same day we heard the present appeal. In Northwest Racquet, we held that where investors in a federally regulated institution subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital, and where the issuing institution applies such investments to regulatory capital, the investments must be regarded as fully encumbered by the regulatory obligation to remain subordinate to the claims of depositors and general creditors in the event of insolvency.

The Securities and Securities Agreement at issue in this case are nearly identical to those discussed in Northwest Racquet. As in Northwest Racquet, there is no dispute that the investment, in fact, was included in MWF's regulatory capital from March through November 1988.

Further, the underlying allegations of fraud in the inducement presented in each case also are nearly identical. We therefore refer the reader to our discussion in Northwest Racquet, and hold that MWF's insolvency precludes Adams from rescinding the Securities Agreement.[13] Adams' claim therefore remains subordinate to the claims of general creditors. The continuing subordinated status of the Securities means that they lack the requisite

---

[13]We also note that Adams, unlike the plaintiff in Northwest Racquet, did not initiate any remedial action against MWF prior to the declaration of MWF's insolvency. Northwest Racquet attempted to exercise its contractual right to accelerate payment prior to the declaration of insolvency. Adams, by comparison, did not take any remedial action until he filed his initial complaint on March 21, 1989, five weeks after the declaration of insolvency. Thus, the facts of this case provide an even stronger basis for holding that the subordinated debt holder is precluded from rescinding than those presented in Northwest Racquet.

mutuality of obligation required to set them off against the promissory note which holds a superior general creditor rank.[14] The continuing subordination also means that Adams is not entitled to share in any pro rata distribution of assets with MWF's general creditors. Because Adams has no right to participate in any pro rata distribution of assets to general creditors, we also hold that the

---

[14]Generally, the right to setoff exists only as to mutual debts. See, e.g., Sioux Line R.R. v. Escabana & Lake Superior R.R., 840 F.2d 546, 551 (7th Cir. 1988). To exhibit the requisite mutuality, the debts must be in the same right. See 5A Michie, Banks & Banking ch. 9, § 115c (1983). Subordinated debentures, however, do not exist in the same right as promissory notes, thus they may not be set off against each other. See FDIC v. Texarkana Nat'l Bank, 874 F.2d 264, 268-69 (5th Cir. 1989) (subordinated debentures in insolvent bank do not, as a matter of both law and equity, meet mutuality of obligation test); see also FDIC v. de Jesus Velez, 678 F.2d 371 (1st Cir. 1982) (subordinated debentures in insolvent bank not mutually extinguishable with promissory notes).

district court properly dismissed his claim attacking the validity of the purchase and assumption agreement between FSLIC and Midwest Savings.

One final issue merits individual attention. Adams contends that the district court should not have dismissed as moot his common law fraud claim for damages against FSLIC in its capacity as receiver for MWF. We agree with the district court's decision declaring the claim moot on prudential grounds because the Bank Board's determination that MWF's assets were insufficient to meet the claims of general creditors meant that the court could not grant subordinate debt holder Adams any effectual relief. 731 F. Supp. at 357-58.

Although it is true, as Adams contends, that in some instances a claim for damages is not mooted merely because of

the insolvency of the defendant, see Ratner v. Sioux Natural Gas Corp., 770 F.2d 512 (5th Cir. 1985), "the feasibility or futility of effective relief should a litigant prevail" remains a crucial consideration in this court's determination of whether to adjudicate a claim on its merits. In re AOV Indus., Inc., 792 F.2d 1140, 1147-48 (D.C. Cir. 1986). To satisfy the case or controversy requirement of Article III of the Constitution, Adams' claimed injury must be redressable by a favorable judicial decision. Iron Arrow Honor Society v. Heckler, 464 U.S. 67, 70 (1983) (per curiam).

The Bank Board formally determined that the claims of subordinated debt holders like Adams are worthless. We are bound by the Bank Board's worthlessness

determination in this proceeding.[15] See Gulley v. Sunbelt Sav., F.S.B., 902 F.2d 348, 351 (5th Cir. 1990), cert. denied, ___ U.S. _____, 111 S. Ct. 673 (1991); Village South Joint Venture v. Federal Deposit Ins. Corp., 733 F. Supp. 50 (N.D. Tex. 1990); Federal Sav. & Loan Ins.

---

[15]A Bank Board determination of worthlessness is a "final agency action, which is reviewable under the provisions of the Administrative Procedure Act [, 5 U.S.C. §§ 701-706,] in an action against the Bank Board, but not subject to collateral attack through discovery or other means in individual lawsuits against the receiver." Federal Sav. & Loan Ins. Corp. v. Locke, 718 F. Supp. 573, 586 (W.D. Tex. 1989). Adams has not directly challenged the Bank Board's worthlessness determination. Rather, he has attacked the determination only collaterally, in the context of this action, which does not name the Bank Board as a party to the litigation, but is stated simply against the RTC, as receiver for MWF. Such a collateral attack is not sufficient to create a justiciable issue in the context of the present case. In the absence of a prior adjudication that the Bank Board's worthlessness determination was arbitrary and capricious, Adams has failed to sufficiently state a claim upon which relief could be granted.

Corp. v. Locke, 718 F. Supp. 573, 586 (W.D. Tex. 1989). The import of this determination is that FSLIC, as receiver for MWF, will never have any assets with which to satisfy a common law fraud judgment. Under these circumstances, we follow the axiomatic principle that when "it [is] impossible for [a] court, if it should decide the case in favor of the plaintiff, to grant him any effectual relief whatever, the court will not proceed to a formal judgment."[16] Mills v.

---

[16]In Ratner v. Sioux Natural Gas Corp., 770 F.2d 512 (5th Cir. 1985), which Adams cites in support of his arguments, the court, in addressing a mootness defense by an insolvent corporation, stated that the "mere possibility that a judgment debtor lacks the means to satisfy its monetary liability" does not necessarily mean that the case is moot. 770 F.2d at 516 (5th Cir. 1985). Here we are dealing not with the "mere possibility," but rather an absolute certainty that defendant RTC, as receiver for MWF, lacks the means to satisfy a judgment on the common law fraud claim. See Federal Sav. & Loan Ins. Corp. v. Locke, 718 F. Supp. 573, 587 n.4 (W.D. Tex. 1989). Adams contends

Green, 159 U.S. 651, 653 (1895).

Adams contends that adjudication of his claim on the merits is warranted, nonetheless, because resolution of the fraud claim on the merits would aid him in pursuing his pending claims against the former officers of MWF individually. Prudential concerns of judicial economy and preservation of scarce judicial resources counsel that Adams pursue any overlapping issues of fraud within the context of those proceedings.

---

that pending litigation over disputed MWF assets raises the possibility that some money may be available, at some future date, to satisfy a common law fraud judgment. This argument, however, overlooks the fact that the assets now belong to Midwest Savings as a result of the purchase and assumption agreement, not to the RTC, as receiver for MWF. RTC no longer holds any MWF assets, let alone assets which might be used to satisfy a judgment in favor of Adams.

III. CONCLUSION

For the reasons expressed above, we affirm the judgment of the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 90-5123MN

Stephen Adams,

Appellant,

vs.

Resolution Trust Corporation as Receiver for Midwest Federal Savings and Loan Association; Harold W. Greenwood, Jr.; Donald Snede; and John Does 1-10,

Appellees.

No. 90-5124MN

Stephen Adams,

Appellant,

vs.

Federal Deposit Insurance Corporation (FDIC) as manager of the FSLIC Resolution Fund,

Appellee.

Appeals from the United States District Court for the District of Minnesota

JUDGMENT

This appeal from the United States District Court was submitted on the record of the district court, briefs of the parties and was argued by counsel.

After consideration, it is ordered and adjudged that the judgment of the district court in this cause is affirmed in accordance with the opinion of this Court.

February 28, 1991

A true copy.

ATTEST: /s/ Robert D. St. Vrain

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT
MANDATE ISSUED: 4/2/91

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Nos. 89-5526 and 89-5585

Northwest Racquet Swim
& Health Clubs, Inc.,
a Minnesota corporation,

Appellant,

v.

Resolution Trust Corporation,
as receiver for Midwest Federal
Savings and Loan Association
and Midwest Savings Association, F.A.,

Appellees.

Submitted: September 12, 1990

Filed: February 28, 1991

Appeals from the United States District Court for the District of Minnesota.

Before McMILLIAN, Circuit Judge, BRIGHT, Senior Circuit Judge, and BOWMAN, Circuit Judge.

BRIGHT, Senior Circuit Judge.

Northwest Racquet Swim & Health Clubs, Inc. (Northwest) appeals the district court's[1] grant of summary judgment[2] in favor of the Resolution Trust Corporation (RTC) in this action for rescission of subordinated debt securities purchased from now insolvent Midwest Federal Savings and Loan Association (MWF). On appeal, Northwest contends that MWF's insolvency does not affect its right to rescind the securities which MWF fraudulently induced it to purchase. Northwest further asserts that its post-insolvency act of rescission of the securities elevated the

---

[1]The Honorable Harry H. MacLaughlin, United States District Judge for the District of Minnesota.

[2]The district court's decision is reported as Northwest Racquet Swim & Health Clubs, Inc. v. Federal Sav. & Loan Ins. Corp., 721 F. Supp. 211 (D. Minn. 1989).

subordinated debt to general creditor status, entitling it to set off the debt against its promissory note obligations to MWF. We affirm the judgment of the district court and substantially agree with its well-reasoned opinion.

I. BACKGROUND

On December 29, 1987, Northwest, a developer and operator of health clubs, purchased $15 million in subordinated debt securities (Securities) in a private offering by MWF, a Minneapolis based, federally insured savings and loan association. Northwest financed its investment with funds from two promissory notes totaling $59 million which it had previously executed with MWF also in December 1987.[3] The Securities contained

---

[3]Northwest executed the promissory notes for $10 million and $49 million on December 1 and December 10, 1987, respectively.

language expressly subordinating Northwest's claim, in the event of liquidation, "to all claims against [MWF] having the same priority as savings account holders or any higher priority."[4] Joint Appendix (J.A.) 33. The parties also entered into a subordinated debt securities agreement (Agreement) which similarly subordinated Northwest's claim in the event of the liquidation of MWF.[5]

---

[4]The priority scheme governing claims against an insolvent thrift institution placed savings account holders in the sixth priority position after various administrative costs, expenses and debts associated with the appointment and operation of the receivership, various wage and benefits claims of the employees of the failed thrift and certain government tax claims. 12 C.F.R. § 569c.11 (1989).

[5]In addition, Northwest executed an Offeree Statement representing that it had "sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of [the] proposed investment," that it was "able to bear the economic risk of the proposed investment," and that it had "considered that it might have to hold

The Agreement specified Northwest's remedies in the event of default. Events of default included failure to make timely payment of the principal or interest due, declaration of insolvency, or the appointment of a conservator, receiver or liquidating agent. A default would also arise in the event that "any representations or warranty made in writing by or on behalf of [MWF] herein or in connection with the transactions contemplated hereby shall prove to have been false or incorrect in any material respect on the date as of which made." J.A. 36.

In the event of a default, the remedies

---

the proposed investment for an indefinite period of time and might have to bear a complete economic loss." J.A. 177. Northwest similarly executed a Subscription Agreement in which it again stated it had "considered and understands the high degree of risk of the securities offered." J.A. 178.

section provided that Northwest could act to protect and enforce its rights by instituting an action in law, suit in equity, or other appropriate proceeding. However, the Agreement placed three significant limitations upon Northwest's rights, powers and remedies. First, Northwest could accelerate payment in the event of default only to the extent that such payment did not leave MWF with insufficient capital to meet regulatory capital requirements set out in 12 C.F.R. § 563.13 (1988). Second, in the event the Federal Savings and Loan Insurance Corporation (FSLIC) was appointed receiver for MWF, FSLIC would have no obligation to arrange for the assumption of the Securities. Finally, the Agreement bound Northwest to abide by the priority scheme set out in Federal Home

Loan Bank Board[6] (Bank Board) regulations governing the distribution of assets in liquidation proceedings.[7]

The sale of the Securities was contingent upon Bank Board approval pursuant to 12 C.F.R. § 563.8-1 (1988), governing the issuance of subordinated debt securities by federal savings and loan associations. The Bank Board, on December 21, 1987, approved the sale and issuance of up to $25 million in MWF

---

[6]The Federal Home Loan Bank Board acted as the principal regulator of the federal savings and loan industry until August 9, 1989, when Title IV of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 354, became law, abolishing the Bank Board and replacing it with the Office of Thrift Supervision.

[7]Under the regulatory priority scheme, see note 4, the claims of subordinated debt holders like Northwest held a ninth rank priority, behind the claims of all general creditors, and ahead only of equity interest holders. 12 C.F.R. § 569c.11 (1989).

subordinated debt securities.

On December 31, 1987, MWF applied the Securities to its regulatory capital, where it constituted more than ten percent of MWF's total regulatory capital through November 1988.[8] In January 1989, however, the Bank Board issued a

---

[8]Regulatory capital is the sum of, inter alia, reserve accounts, retained earnings, permanent common stock, securities which constitute permanent equity capital, appraised equity capital and any other nonwithdrawable accounts which constitute the institutional reserves available for satisfying the claims of depositors and other account holders. See 12 C.F.R. § 561.13 (1988). Pursuant to statutory authority, 12 U.S.C. § 1464(s), the Bank Board, and its successor, the Office of Thrift Supervision (OTS), sets the minimum capital requirements for the industry. Since 1973, the Bank Board or OTS has permitted thrift institutions to include long-term subordinated debt securities in their regulatory capital because such securities possess many of the characteristics of permanent capital. 54 Fed. Reg. 34,148 (1989) (commentary accompanying Final Rule amendments to regulations governing the issuance and use of subordinated debt (codified at 12 C.F.R. § 563.13 (1989))).

directive ordering MWF to prospectively remove the Securities from regulatory capital because Northwest had purchased them with funds it had borrowed from MWF on an unsecured basis. MWF, accordingly, did not report the Securities as regulatory capital in its 1988 fourth quarter report to the Bank Board.

Publicity concerning MWF's troubled financial condition prompted Northwest, by letter dated January 25, 1989, to notify MWF that it considered the subordinated debt security to be in default. The letter stated that the events of default "include[d] but are not limited to breach of representations and warranties" made in the Agreement regarding the financial condition of MWF. J.A. 197. Northwest accordingly declared that it was exercising its remedies as set forth in the Agreement.

Specifically, Northwest declared an acceleration of payment of the balance of the principal and demanded immediate payment "in the manner and with the effect provided in the Debenture Agreement." J.A. 198. Northwest also declared an immediate setoff of any remaining amount against its promissory note obligations to MWF.

On February 13, 1989, the Bank Board declared MWF insolvent after finding that its obligations to its creditors (including savings account holders) exceeded its assets. Accordingly, the Bank Board, acting pursuant to its statutory authority under 12 U.S.C. § 1464(d)(6)(A)(i) (1988), named FSLIC as conservator of MWF. FSLIC attempted to operate MWF as a going concern. On March 10, 1989, Northwest again informed MWF by letter that it had concluded that the

sale of the Securities had "involved the misrepresentation of material facts and willful failure to disclose material facts . . . pertaining to the financial condition of [MWF]." J.A. 201. This time, however, rather than assert its contractual remedies as it did in the January 25 letter, Northwest tendered the Securities in rescission and declared an immediate setoff of the amount due against the balance of the two promissory notes held by MWF.

Northwest formalized its allegations of fraud by filing the complaint giving rise to this action in April 1989. The complaint, as later amended, alleged that MWF's material misrepresentations and nondisclosures at the time of the transaction violated state and federal

securities laws.[9] Northwest asked the court to declare the Securities and the Agreement rescinded. It further sought a declaration that the rescission elevated the Securities obligation to general creditor status. According to Northwest, the elevation of the Securities to general creditor status meant that the debt possessed a mutuality

---

[9]The financial statements appended to and incorporated into the Agreement stated that an MWF asset identified as a "Finance and Excess Service Fee Income Receivable" had a value of approximately $207 million. Northwest alleged that, at the time of the transaction, MWF officials knew and failed to disclose to Northwest that the asset, which is presently the subject of separate litigation, was likely worth far less than $207 million represented in the financial statements upon which Northwest based its decision to invest. Northwest asserted in its complaint that this material misrepresentation violated § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1988), and Minn. Stat. § 80A.01 (1986).

of obligation with the two promissory notes, entitling it to set off the Securities against the notes.

On May 4, 1989, the Bank Board, noting that MWF's liabilities continued to exceed its assets, concluded that MWF could not be operated as a going concern. Acting under statutory authority, 12 U.S.C. § 1464(d)(6)(A) (1988); 12 C.F.R. § 547 (1988), the Bank Board appointed FSLIC as receiver for the purpose of liquidating MWF. Accordingly, FSLIC, by operation of law, took possession of MWF and succeeded to all of MWF's rights, titles, powers, and privileges. See 12 U.S.C. §§ 1464(d), 1729 (1988). In addition, the Bank Board determined that the total liquidation of MWF would not generate sufficient funds to satisfy the claims of MWF's general creditors, thus, it formally declared all subordinated

debt and equity interests in MWF to be worthless.[10]

The Bank Board also contemporaneously created a new savings and loan association, Midwest Savings Association (Midwest Savings), to facilitate the liquidation of MWF and the reorganization of its assets. The Bank Board immediately placed Midwest Savings under FSLIC conservatorship. It further directed FSLIC to enter into a purchase and assumption agreement with Midwest Savings, transferring most of MWF's

---

[10]The settlement of claims in the event of liquidation proceeded under any absolute priority scheme, meaning that ninth and tenth priority subordinated debt and equity holders could receive treatment of their claims only after all claims of the first eight ranks had been fully satisfied. 12 C.F.R. § 569c.11(d) (1989). Thus, the Bank Board's determination that MWF's assets were insufficient to satisfy the claims of seventh priority general creditors meant that no money remained for the claims of ninth priority subordinated debt holder like Northwest.

assets to Midwest Savings in consideration for Midwest Savings' assumption of certain MWF liabilities.

Under the purchase and assumption agreement, Midwest Savings did not assume any MWF equity liabilities or obligations, including the subordinated debt securities at issue here. As a result of this transaction, the obligations arising from the Securities remained with FSLIC, as receiver for MWF, while Midwest Savings assumed possession of the promissory notes against which Northwest sought to exercise its claimed right of setoff. Northwest accordingly amended its complaint to include Midwest Savings as a defendant and requested that the court preliminarily enjoin Midwest Savings from further selling or transferring the notes which Northwest sought to set off.

FSLIC filed a Fed. R. Civ. P. 12(b)(6) motion to dismiss for failure to state a claim. The district court, finding that the disposition of the motion turned on matters outside the pleadings, treated it as a motion for summary judgment and ruled in favor of FSLIC. The district court adopted the analysis of the Second Circuit in In re Weis Sec., Inc., 605 F.2d 590 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979), and held, as a matter of law, that because MWF had applied the funds from the sale of the Securities to its regulatory capital accounts, Northwest was precluded from rescinding the Securities after the Bank Board had declared MWF insolvent. The Securities, therefore, remained subordinated, and thus lacked the requisite mutuality of obligation necessary to set them off against the two

promissory notes.[11] Northwest filed this appeal in which it renews the arguments it presented before the district court.[12]

II. DISCUSSION

We review a grant of summary judgment under the same standard applied by the district court. McCuen v. Polk County, Iowa, 893 F.2d 172, 173 (8th Cir. 1989).

---

[11]The district court also denied Northwest's motion to enjoin Midwest Savings from further selling or transferring the promissory notes because the motion was predicated upon Northwest's claimed right to set off the Securities against the notes.

[12]During the pendency of this action, Congress created the Resolution Trust Corporation (RTC) as part of its 1989 restructuring of the federal savings and loan regulatory system. See Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183. Under the regulatory reorganization, the RTC assumed most of the receivership, conservatorship and liquidation functions of the FSLIC. Consequently, RTC replaced FSLIC as receiver for MWF and conservator of Midwest Savings, and now stands in FSLIC's place as defendant and appellee in this action.

Thus, we review the facts de novo, Didier v. J.C. Penney Co., 868 F.2d 276 (8th Cir. 1989), and affirm the district court only if we agree that "there is no genuine issue of material fact, viewing the facts in the light most favorable to the non-moving party, and that the moving party is entitled to judgment as a matter of law." McCuen, 893 F.2d at 173 (citing Kegel v. Runnels, 793 F.2d 924, 926 (8th Cir. 1986)); see Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 48 (1986).

Viewing the facts in the light most favorable to Northwest, we must assume that MWF did indeed fraudulently induce Northwest to purchase the Securities by making material misrepresentations regarding its financial condition at the time of the transaction. Neither party disputes that MWF immediately applied the

investment to regulatory capital. In addition, neither party disputes that, as of February 13, 1989, MWF was insolvent. On the basis of these facts, the district court held that Northwest, as a matter of law, was precluded, as of the date of MWF's insolvency, from rescinding the sale of the Securities. Northwest did not attempt to rescind until March 10, 1989, nearly one month after the Bank Board's declaration of MWF's insolvency, thus it was barred from rescinding the Securities.

In reaching its decision, the district court concluded that In re Weis Sec., Inc., 605 F.2d 590 (2d Cir. 1978), resolved the outcome of this case. We therefore focus our attention on Weis. In Weis, lenders to a securities broker-dealer subordinated their loans to the claims of all other creditors in exchange

for a higher rate of return. The subordination, which in effect rendered the loans unencumbered for regulatory purposes, enabled Weis to comply with industry regulatory capital requirements necessary to continue operations. Following Weis' insolvency, the lenders, claiming fraud in the inducement, sought to rescind the subordination agreements.

The Second Circuit rejected the Subordinated lenders' claims, holding that because the lenders had subordinated their loans specifically to enable Weis to comply with regulatory capital requirements, they were estopped from rescinding their subordination agreements following Weis' declaration of insolvency, regardless of whether general creditors actually relied upon the subordination in extending credit to the company. The Weis court analogized the

position of the lenders to shareholders in a series of cases arising under the old National Banking Act, in which those purchasing shares of a national bank were conclusively presumed to have known that they had increased the bank's capital and facilitated its conduct of business. 605 F.2d at 595 (construing Scott v. Deweese, 181 U.S. 202 (1901)). Having assumed such a position, the shareholders were not permitted to escape their statutory liability to the banks creditors at the time of insolvency.[13]

In Scott v. Deweese, for example, a shareholder claiming that he was fraudulently induced to invest in a national bank sought to rescind after the bank had declared its insolvency. In

---

[13]Prior to 1959, shareholders of national banks were statutorily liable for the banks' obligations to the extent of the par value of their shares. 12 U.S.C. § 63 (1958) (repealed 1959).

rejecting the shareholder's claim, the Court stated:

> The present suit is primarily in the interest of creditors of the bank. It is based upon a statute designed not only for their protection but to give confidence to all dealing with national banks in respect of their contracts, debts and engagements, as well as to stockholders generally. If the subscriber became a shareholder in consequence of frauds practiced upon him by others, whether they be officers of the bank or officers of the Government, he must look to them for such redress as the law authorizes, and is estopped, as against creditors, to deny that he is a shareholder . . . if at the time the rights of creditors accrued he occupied and was accorded to rights appertaining to that position.

181 U.S. at 213. By analogy, the court in Weis held that, having assumed a subordinate position in order to enable to company to meet federally mandated regulatory capital requirements necessary to continue operations, the lenders were similarly estopped from rescinding their subordination after the date of

insolvency.[14]

The district court deemed Weis analogous to the present action because Northwest's investment, like those of the lenders in Weis, was applied to the regulatory capital of the issuing institution. We agree. The district court stated the Weis "is premised on the fact that the capital regulations reflected 'a strong desire to assure investors of the stability and integrity of the securities markets and of the broker-dealers responsible for channeling investments into them.'" Northwest Racquet Swim & Health Clubs, Inc. v.

---

[14]The declaration of insolvency is the critical moment in determining the relationship between various competing interests because "[i]t is well settled that the rights and liabilities of a bank and the bank's debtors and creditors are fixed at the declaration of the bank's insolvency." American Nat'l Bank v. FDIC, 710 F.2d 1528, 1540 (11th Cir. 1983) (citations omitted).

Federal Sav. & Loan Ins. Corp., 721 F. Supp. 211, 216 (D.Minn. 1989) (quoting Weis, 605 F.2d at 596). We believe, contrary to Northwest's assertion, that the regulatory capital requirements of the thrift industry serve similar regulatory interests and purposes as those in the securities industry.

In both industries, regulatory capital acts as a cushion helping the institution to absorb losses in lean times, thus ensuring customers, investors in the securities context and depositors[15] in the

---

[15]The purposes of regulatory capital requirements are typically framed in terms of the risk of loss borne by FSLIC (and now the Federal Deposit Insurance Corporation (FDIC)) rather than depositors per se. However, Congress created thrift deposit insurance to promote thrift and protect savings by ensuring that the "saver will get his money back." H.R. Rep. No. 1922, 73d Cong., 2d Sess. 3 (1934) (accompanying Title IV of the National Housing Act, codified as amended as 12 U.S.C. §§ 1724-1730i (1988), repealed by Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-

savings and loan context, of the stability and integrity of the institution in which they have placed their money. See 53 Fed. Reg. 51,800 (proposed Dec. 23, 1988) (commentary on "Purpose of Regulatory Capital" accompanying proposed amendments to regulatory capital requirements codified at 12 C.F.R. §§ 561, 563).[16] The protection provided by regulatory capital requirements, thus, is most critical

---

73, Title IV, § 407, 103 Stat. 363) (emphasis added). It is therefore appropriate to view the interests of FSLIC as synonymous with the interests of depositors.

[16]Regulatory capital requirements also "reduce the 'moral hazard' engendered when the insurer bears most of the cost of a thrift's failure . . . [by ensuring that] initial losses are borne not by the insurer, but by the institution's equity and subordinated debt holders, who, through their control of the institution's management, control the actions most likely to lead to insurance losses." 53 Fed. Reg. 51,800 (1988) (emphasis added).

during an economic downturn, and particularly in the event of insolvency. This protection would be severely undermined if, at the time when the protection was most sorely needed, claims of general creditors or depositors were made contingent upon the lower priority claims of subordinated debt and equity interests.[17]

---

[17]We disagree with Northwest that Oppenheimer v. Harriman Nat'l Bank & Trust Co., 301 U.S. 206 (1937), sanctions just such a contingency of depositor and general creditor claims. in Oppenheimer, the Court did permit a shareholder in a national bank to rescind his investment on the basis of the bank's fraud after the bank had declared its insolvency. However, the Court deemed the right to rescission contingent upon prior satisfaction of Oppenheimer's statutory liability to the bank's creditors. The Court allowed Oppenheimer's rescission only because he had previously satisfied his statutory obligation:

> Plaintiff appeared by the bank's records to be a stockholder and, as against creditors for whose benefit the statutory liability was created, was estopped from denying that status. Recognizing that the bank's fraud and his rescission availed

An action for rescission by a subordinated debt holder after the date of insolvency must be viewed, in effect, as one between the investor and general creditors, including innocent depositors, Scott v. Deweese, 181 U.S. at 212, because the claim of the rescinding investor "Can be satisfied only out of assets which otherwise would be allocated to making innocent parties whole." Slain & Kripke, The Interface Between Securities Regulation and Bankruptcy--Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors, 48 N.Y.U. L.Rev. 261, 286 (1973); see also Scott v. Abbott, 160 F. 573, 581 (8th Cir.), cert. denied, 212 U.S. 571 (1908); In re Stirling Homex

---

nothing against the comptroller's assessment, plaintiff paid the amounts laid against him.

301 U.S. at 214.

Corp., 579 F.2d 206, 213 (2d Cir. 1978), cert. denied, 439 U.S. 1074 (1979). It is fair to suggest, in a case such as the one now before us, that all of the parties are victims of the institution's fraud. The question thus becomes which party should receive priority in the settlement of their claims: the investor, who is in the best position to judge the condition of the thrift and influence its management, or the innocent depositors and general creditors.

Northwest asks that the subordinated debt holder be given an equal bite at the apple. This argument is a familiar one which brings to mind the observation of this court many years ago that in the event of an insolvency, "the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of a creditor, is very strong."

Newton Nat'l Bank v. Newbegin, 74 F. 135, 140 (8th Cir. 1896), quoted in In re Stirling Homex Corp., 579 F.2d at 213. Northwest's request overlooks the fact that the depositors and general creditors "did nothing to create the rescinder's problems and in the overwhelming majority of cases . . . reli[ed] on the existence of the equity or junior debt cushion which the rescinder purported to provide." Slain & Kripke, 48 N.Y.U. L. Rev. at 286. In such situations, fairness and equity dictate that investors, having undertaken the greater risk, give way to the depositors and general creditors by honoring the regulatory obligations they have assumed. It is the regulatory interest of protecting the innocent depositors and general creditors which drove the Second Circuit's analysis in Weis which we now

adopt.

Northwest asserts, however, that under Weis, it cannot be said to have undertaken such a regulatory obligation without a showing that it subordinated its claims with the specific intent of enabling MWF to meet its regulatory capital requirements. As noted above, the lenders in Weis did execute the subordination agreements with the specific intention of enabling Weis to meet its regulatory capital requirements. By comparison, Northwest asserts that it did not know the MWF needed, or would use, the proceeds of the sale of the Securities for regulatory capital purposes. Northwest thus asserts that Weis does not apply under the facts of this case.

We agree that the specific intention of the lenders in Weis was a factor in

the Second Circuit's decision. However, we believe that Northwest reads the implications of Weis too narrowly in light of the regulatory interests at stake. While the facts of Weis appear to limit its application to subordinations with the specific intent of enabling a federally regulated institution to meet mandatory capital requirements, we believe its rationale extends to situations in which parties subordinate their claims in such a manner as to make the investments eligible for use as regulatory capital. Once a federally regulated institution applies such investments to its regulatory capital base, the investors must be conclusively presumed to know that they have increased the institution's capital and facilitated the conduct of its business. See Scott v. Deweese, 181 U.S. at 212. Any other

result would undermine the regulatory protections and priorities accorded innocent third parties who rely upon stated capital reserves.

Under the standard we now enunciate, it is clear that under the facts as presently constituted, Northwest, as a matter of law, is not entitled to any relief. First, both the Securities and the Agreement were structured to render the investment available for use as regulatory capital. The Agreement expressly required that the sale be approved by the Bank Board pursuant to 12 C.F.R. § 563.8-1 (1988), which sets forth numerous terms and conditions for the issuance of subordinated debt securities. Subordinated debt securities meeting the terms and conditions of § 563.8-1 were eligible for use as regulatory capital. 12 C.F.R. § 561.13(c)(1) (1988) ("The

term 'regulatory capital' also includes subordinated debt securities issued pursuant to § 563.8-1").

Section 563.8-1 expressly employs the term "regulatory capital" in conjunction with subordinated debt securities. See 12 C.F.R. § 563.8-1(b)(2)(i) (1988).[18] This provision suggests to us that a subordinated investor such as Northwest should recognize the link between subordinated debentures and regulatory capital, and, more to the point, that this sort of investment might be applied to regulatory capital. We also consider telling the language in the Agreement, as required by the regulations, 12 C.F.R. § 563.8-1(d)(1)(iv) (1988), clearly stating

---

[18]We also note that the regulatory capital requirements set out at 12 C.F.R. § 563.13 were expressly referred to in both the regulation governing the approval of the sale of the Securities, and the Agreement itself.

that no payment of principal shall be accelerated without approval of the Bank Board if such payment would leave MWF with insufficient regulatory capital. In agreeing to this provision, Northwest, again, expressly limited its rights and remedies to those available to contributors to regulatory capital. Finally, Northwest agreed to subordinate its claims to those claims having the same priority as savings account holders or higher, again a condition of investments to be devoted to regulatory capital. See 12 C.F.R. § 563.8-1(d)(1)(ii) (1988). Having agreed to terms and conditions that made its investment eligible for use as regulatory capital, Northwest should not now be heard to complain that it was in fact

used in this manner.[19]

Having determined that Northwest Clearly subordinated its investment in a manner that made it eligible for use as regulatory capital, we next look to the record to determine whether the funds, in fact, were used for that purpose. On this issue, there is not dispute. MWF included the investment in regulatory capital beginning in the fourth quarter of 1987 and continuing at least through the third quarter of 1988. We should note that the Bank Board's January 1989 directive instructing MWF to remove the

---

[19]If Northwest had alleged that, at the time of the transaction, MWF specifically indicated that the money would not be used for regulatory capital purposes, then we might view this case differently. However, that is not the case we have before us. Northwest has merely asserted that MWF did not expressly state that the investment would be used as regulatory capital. This allegation simply does not create a genuine issue of material fact in light of the terms of the Agreement.

Securities from its reported regulatory capital does not affect our analysis. The Bank Board directed MWF to remove the Securities from regulatory capital only prospectively. The purely prospective nature of the action means that, for regulatory purposes, the Securities must be regarded as regulatory capital from December 1987 until November 1988. Thus, in the final analysis, Northwest's investment must be regarded as fully encumbered by the regulatory obligation to remain subordinate to the claims of depositors and general creditors in the event of insolvency.[20]

---

[20]Had the Bank Board ordered the removal of the Securities from MWF's regulatory capital account retrospectively as well as prospectively, this case might have more closely resembled FDIC v. United States Nat'l Bank, 685 F.2d 270 (9th Cir. 1982), upon which Northwest relies. In United States Nat'l Bank, the court permitted a subordinated debt holder to rescind its fraudulently induced investment in a bank despite the fact that the debt holder did

In holding that Northwest may not rescind, we emphasize that we do not hold that a subordinated investor who had agreed to terms and conditions that make his investment eligible for inclusion in regulatory capital never had recourse for fraud. We hold only that such investors may not rescind after the issuing

---

not rescind until after the bank had been declared insolvent. The FDIC, as receiver for the insolvent bank, argued that Weis should apply and that no rescission should be permitted post-insolvency. However, National Banking Act regulations governing the subordinated loan at issue in United States Nat'l Bank prohibited the use of subordinated debt as regulatory interests at stake in United States Nat'l Bank. Thus, the court ruled that Weis, in which the subordinated loans could be, and were, used as regulatory capital, was distinguishable and did not apply. For the very reason that the court in United States Nat'l Bank concluded that Weis did not apply, we conclude that United States Nat'l Bank must be distinguished on its facts and does not apply in the present case.

institution has been declared insolvent.[21] The continuing subordinated status of the Securities meas that they lack the requisite mutuality of obligation required to set them off with the promissory note which possesses a superior general creditor rank.[22]

---

[21]RTC has asserted that Northwest bound itself to an exclusive set of remedies to apply even in the event of fraud in the inducement, thus suggesting that Northwest cold not have rescinded even prior to the date of insolvency. Our holding does not require us to pass judgment on this issue.

[22]Generally, the right to setoff exists only as to mutual debts. See, e.g., Sioux Line R.R. v. Escabana & Lake Superior R.R., 840 F.2d 546, 551 (7th Cir. 1988). To exhibit the requisite mutuality, the debts must be in the same right. See 5A Michie, Banks & Banking ch. 9, § 115c (1983). Subordinated debentures do not exist in the same right as promissory notes, thus they may not be set off against each other. See FDIC v. Texarkana Nat'l Bank, 874 F.2d 264, 268-69 (5th Cir. 1989) (subordinated debentures in insolvent bank do not, as a matter of both law and equity, meet mutuality of obligation test); see also FDIC v. de Jesus Velez, 678 F.2d 371 (1st Cir. 1982) (subordinated debentures in insolvent bank not mutually

III. CONCLUSION

For the reason expressed above, we affirm the judgment of the district court.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

---

extinguishable with promissory notes).

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
Civil No. 4-89-330

Stephen ADAMS

v.

RESOLUTION TRUST CORPORATION, as Receiver for Midwest Federal Savings and Loan, et al.

February 9, 1990.
As Amended
March 2, 1990.

Timothy D. Kelly, Diane M. Helland, KELLY & BERENS, 80 South Eighth Street, #3720, Minneapolis, Minnesota 55402, for plaintiff.

John Paul Martin, John E. Yanish, Jeffrey G. Stephensen, PETERSON, TEWS & SQUIRES, 80 South Eighth Street, #4800, Minneapolis, Minnesota 55402, for defendant RTC.

ORDER

ROSENBAUM, District Judge

Defendant FSLIC (the Federal Savings and Loan Insurance Corporation), now the

RTC (Resolution Trust Corporation),[1] in its role as receiver for Midwest Federal Savings and Loan Association (Midwest Federal), seeks judgment on the pleadings, pursuant to Rule 12, Federal Rules of Civil Procedure, (Fed.R.Civ.P.).[2] Based upon the files, records, proceedings, and oral arguments herein, and for the reasons set forth

---

[1]On August 9, 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) became law. Pub.L.No. 101-73, 103 Stat. 183. Section 401(f) (2) abolishes the FSLIC and substitutes the Resolution Trust Corporation (RTC) as its successor. Id. at 356. A stipulation and order to substitute RTC, as receiver, for FSLIC, as receiver, was signed by the parties and the magistrate and was filed November 7, 1989. For purposes of this motion the Court will continue to refer to the defendant as the FSLIC.

[2]While the FSLIC has styled its pleading as a motion to dismiss pursuant to Rule 12(b)(6), Fed.R.Civ.P., the Court has considered affidavits and documents outside the pleadings. Thus, this motion is treated as one for summary judgment. Rule 12(b) and (c) and Rule 56, Fed.R.Civ.P.

below, defendant's motion, considered as if for summary judgment, is granted.

Facts

Plaintiff is a Florida businessman who purchased $2.5 million in subordinated debentures issued by Midwest Federal on March 31, 1988. Defendant FSLIC was a congressionally created agency of the United States charged with protecting the financial integrity of the savings and loan industry. The RTC, FSLIC's statutory successor, is currently the receiver for Midwest Federal, a failed financial institution.

On February 13, 1989, some ten months after plaintiff's purchase of the subordinated debentures, the Federal Home Loan Bank Board (FHLBB) determined that Midwest Federal was insolvent and appointed the FSLIC as conservator of Midwest Federal. FHLBB Resolution 89-

179, at 2.

On March 21, 1989, plaintiff brought this action against Midwest Federal and several former officers of Midwest Federal.[3] Plaintiff seeks to rescind the subordination agreement claiming he was fraudulently induced to make the $2.5 million loan. Plaintiff also seeks to set off the entire unpaid balance of the subordinated debentures against a $7,845,000 promissory note, dated June 30, 1988, which plaintiff owes to Midwest Federal.

On May 4, 1989, having determined Midwest Federal's assets to be less than

---

[3]The action was originally filed in Hennepin County as a Minnesota state court proceeding against Midwest Federal and others as defendants. It was subsequently removed to this Court on the petition of the FSLIC, as conservator. The parties stipulated on July 6, 1989, to the substitution of the FSLIC, as receiver, as party defendant for Midwest Federal.

its obligations, the FHLBB replaced the FSLIC as conservator with the FSLIC as receiver. FHLBB Resolution 89-1388 at 1-2. On the same date, the FHLBB created a new savings and loan association, Midwest Savings Association. The FHLBB then directed the FSLIC as receiver to transfer substantially all of Midwest Federal's assets, and certain of its liabilities, to Midwest Savings via a purchase and assumption transaction. FHLBB Resolution 89-1389 at 2-5.

The result of these proceedings is that the FSLIC (now RTC), as receiver, holds Midwest Federal's obligation on the subordinated debentures and Midwest Savings, with FSLIC (now RTC) as its conservator, holds plaintiff's obligation on the promissory note.

At the time this case was removed, jurisdiction was conferred upon this

Court by 12 U.S.C. §1730(k)(1).[4]

Plaintiff's Contentions

Plaintiff's 1988 debenture purchase was memorialized in a written agreement. A review of that document shows it to be replete with language making clear the subordinate nature of the debt. The document is entitled "SUBORDINATED DEBT SECURITIES AGREEMENT." Amended Complaint, Ex. C, title page. The introductory paragraph of the agreement states "the Lender agrees to purchase, subordinated debt securities." Id. at 1. Paragraph 1 of the agreement sets forth Midwest Federal's authority to issue subordinated debt securities. Id.

---

[4]Section 407 of FIRREA repeals 12 U.S.C. §1730 (k)(1). Pub.L. No. 101-73, §407, 103 Stat. 183, 363 (1989). Section 209 of FIRREA amends 12 U.S.C. §1819, which is now the relevant jurisdictional provision. Id. at 216. This Court presently has jurisdiction, pursuant to 12 U.S.C. §1819, as amended.

Paragraph 3 states the notes are not secured by the assets of Midwest Federal and cannot be held by an FSLIC-insured institution. Id. at 3. Paragraph 11 states:

> Payment of the principal of and interest on the Notes is hereby expressly subordinated on liquidation to all claims (including post default interest) against [Midwest Federal] having the same priority as savings account holder or any higher priority. Further, for any and all purposes whatsoever, the Notes shall be subordinate to the 8-1/4% $8 million subordinated debentures of [Midwest Federal] due in 1993.

Id. at 14. Paragraph 20 also contains an explicit subordination in the event of the failure of Midwest Federal:

> If the FSLIC shall be appointed receiver for [Midwest Federal] and . . . shall arrange for the assumption of less than all of the liabilities of [Midwest Federal] by one or more other insured institutions, the FSLIC shall have no obligation . . . to contract for or otherwise arrange for the assumption of the obligation represented by the Note in whole or in part . . ..

Id. at 20.

It is plaintiff's contention that he did not know his investment in these debentures would be used to enable Midwest Federal to meet its regulatory capital requirements. In the absence of contrary evidence, at this point in the proceedings, the Court assumes this to be true. But whatever the state of plaintiff's knowledge, Midwest Federal did include the $2.5 million in its regulatory capital. Affidavit of Steven L. Opsal, ¶¶7-9; Affidavit of Lynne Blixt, ¶¶4-6. In January, 1989, the FSLIC directed that Midwest Federal cease the inclusion of the subordinated debentures in its regulatory capital base. Opsal Affidavit at ¶10. The directive was issued because it appeared the subordinated debentures had been purchased with funds loaned by Midwest

Federal.[5]

Plaintiff, by this action, first seeks to rescind the subordinated debenture agreement and, then, seeks to set off the amount he claims is due against his promissory note, now held by Midwest Savings. Plaintiff argues he is entitled to rescission because Midwest Federal made material misrepresentations which induced him to enter into the subordinated debt securities agreement. It is his position that upon rescission he would be entitled to rank in parity with general creditors. He then argues that this elevation in status creates a mutuality of obligation which permits the debentures to be set off against his

---

[5]This arrangement was acknowledged by counsel for plaintiff at oral argument. Tr. of motion proceedings, at 19-20 (Aug. 24, 1989). Plaintiff borrowed from Midwest Federal to secure the funds he used to purchase these debentures.

promissory note. Plaintiff contends the right to set-off was effective upon Midwest Federal's insolvency, so that Midwest Savings took the promissory note subject to the set-off.

Analysis

Summary judgment is appropriate if there is not genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Rule 56(c), Fed.R.Civ.P. "Summary judgment procedure is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the Federal Rules as a whole . . .." Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986). Prior to the Federal Rules of Civil Procedure and notice pleading, motions to dismiss a complaint or strike a defense were the primary tools to prevent factually insufficient claims

from proceeding to trial. Id. Under notice pleading, summary judgment assumes this integral function. Id.

Summary judgment may be granted against a party who fails to make a showing sufficient to establish the existence of an element essential to its case and on which that party will bear the burden of proof at trial. Id. at 322-23. The party opposing summary judgment must produce concrete facts demonstrating there is a genuine issue of fact for trial. Buford v. Termayne, 747 F.2d 445, 447 (8th Cir.1984).

Plaintiff asserts he is entitled to set off these debentures against his loan from Midwest Federal. The right to set-off exists only as to mutual debts. Soo Line R. Co. v. Escanaba & Lake Superior R. Co., 840 F.2d 546, 551 (7th Cir.1988); Olsen-Frankman Livestock Mktg. Serv.,

Inc. v. Citizens Nat'l Bank, 605 F.2d 1082, 1087 (8th Cir.1979). Here, plaintiff purchased debentures which,by their terms, were expressly subordinated to all claims having the same or higher priority as savings account holders.

In Northwest Racket Swim & Health Clubs, Inc. v. Federal Sav. & Loan, Ins. Corp., 721 F.Supp. 211 (D.Minn.1989), Judge MacLaughlin, of this court, considered claims virtually identical to these. His analysis in Northwest Racket is fully applicable here.

The words of the subordinated debt agreement are precisely to the contrary of plaintiff's position. The agreement, by its terms, provides for the purchase of subordinated debt. To overcome this contractual bar, plaintiff attempts to establish mutuality based upon the rule set forth in Oppenheimer v. Harriman

Nat'l Bank & Trust Co., 301 U.S. 206 (1937). Claiming Midwest Federal's fraud and misrepresentation, he asserts himself to be a defrauded purchaser. Citing Oppenheimer, plaintiff concludes a defrauded purchaser is entitled to rank on a parity with general creditors. It is, then, to Oppenheimer, its progenitors, and its progeny which the Court must turn.

It is noted, first, that Oppenheimer did not involve subordinated debt. In Oppenheimer the Supreme Court held that defrauded purchasers of a bank's capital stock could rescind their purchase and rank with the bank's unsecured creditors. 301 U.S. at 214-15. The Court, however, found rescission to be contingent upon payment of a statutorily defined

liability to the bank's creditors.[6] "by payment of the comptroller's assessment they fully discharged their liabilit, as stockholders. And as claimants they stand on the same footing as other creditors." 301 U.S. at 215. See also In re Weis Securities, Inc., 605 F.2d 590, 596 n.12 (2d Cir.1978), cert. denied, 439 U.S. 1128 (1979).

This issue was then considered by the Second Circuit in Weis Securities, which did involve subordinated debt. The Second Circuit refused to allow defrauded lenders to rescind their subordination agreements. That court held that when a lender subordinates a loan to enable a

---

[6]Prior to 1959, shareholders of a national bank were statutorily liable for all obligations of the bank to the extent of the par value of their shares. 12 U.S.C. §64 [repealed]; In re Weis Securities, Inc., 605 F.2d at 590, 595 (2d Cir. 1978), cert. denied, 439 U.S. 1128 (1979).

securities broker to comply with regulatory capital requirements, the lender will be estopped from rescinding the subordination agreement. 605 F.2d at 596. Weis Securities is consistent with Oppenheimer and reflects the fact that the subordination agreements allowed the broker-dealer to comply with regulatory capital requirements. Id.

In Weis Securities, the Court found that whether customers and creditors of the broker-dealer relied on the subordination agreements was irrelevant. Id. This finding was premised on Scott v. Deveese, 181 U.S. 202 (1901). In Scott, the plaintiff sought to rescind his purchase of bank stock, claiming the purchase was fraudulently induced. The Court denied rescission, finding a purchaser of bank shares must be conclusively presumed to have known he

had increased the bank's capital and facilitated the conduct of its business. Id. at 212.

It is true that in Federal Deposit Ins. Corp. v. United States Nat'l Bank 685 F.2d 270 (9th Cir.1982), the Ninth Circuit allowed a defrauded purchaser to rescind its subordinated note agreement and thereby rank with the bank's other creditors. But, in that case, the court found the loan could not be used for regulatory capital under the National Banking Act. Id. at 274-75. Thus, since the subordinated loan in United States Nat'l Bank was not used to enable the bank to comply with regulatory capital requirements, the Ninth Circuit found Weis Securities was not analogous and the Oppenheimer rule was applicable. Id.

Plaintiff argues that, in the absence of his actual knowledge that his loan to

Midwest Federal would be used to meet Midwest Federal's regulatory capital requirements, he fits within the Oppenheimer rule and Weis Securities does not apply. But, like the plaintiff in Weis Securities, the present plaintiff purchased subordinated debt which allowed Midwest Federal to meet regulatory capital requirements. Opsal Affidavit, ¶¶7-9; Blixt Affidavit ¶¶4-6. Plaintiff's contention, that subjective knowledge is the critical concern, misreads the law.

Close analysis reveals that vindication of regulatory interests in the predicate to rescission. In Oppenheimer, the plaintiff's right to parity with other unsecured creditors accrued only upon his payment of a statutory liability to those creditors. The bank's fraud did not discharge that

liability. 301 U.S. at 214-15. In Weis Securities, the court's holding was based on the purposes underlying regulatory capital requirements. Weis Securities, 605 F.2d at 596. In United States Nat'l Bank, the plaintiff's right to parity with unsecured creditors existed only because the subordinated loans did not, in fact, enable the bank to meet regulatory requirements. 685 F.2d at 274-75. In other words, the regulatory interests in Oppenheimer and Weis Securities were satisfied and there was no regulatory interest implicated in United States Nat'l Bank.

The regulatory capital requirements clearly are designed to bolster public confidence in the stability and integrity of financial institutions, thereby encouraging orderly financial transactions and supporting the national

economy. See Weis Securities, 605 F.2d at 596. "To assure creditors that they could rely on the stated capital resources of a bank, the legislature compelled those who had contributed capital to stand by their commitments." Id. When a subordinated loan is used to enable a financial institution to comply with capital regulations, the subordinated lender properly is estopped from rescinding its agreement. See Weis Securities, 605 F.2d at 596.

In this case, plaintiff expressly purchased subordinated debentures. Amended Complaint Ex. C, title page, introductory paragraph, ¶¶1, 3, 11, 20. Midwest Federal reported these subordinated debentures as part of its regulatory capital. Opsal Affidavit, ¶¶7-9; Blixt Affidavit, ¶¶4-6. Plaintiff's own documents repeatedly

refer to regulatory capital, federal regulations governing subordinated debt and regulatory capital, and Midwest Federal's treatment of other subordinated debt as part of regulatory capital.

The Court finds that, as in Scott v. Deweese, plaintiff must be presumed to know that his loan increased Midwest Federal's capital and facilitated the conduct of its business.[7] See Scott, 181 U.S. 202, 212 (1901). Accordingly, plaintiff's present claim of lack of subjective knowledge that Midwest Federal would report the subordinated debentures as regulatory capital is irrelevant.

---

[7]Indeed, at oral argument plaintiff's counsel acknowledged that plaintiff knew he had purchased equity of the bank. Tr. of motion proceedings, at 18 (Aug. 24, 1989).

Plaintiff is a sophisticated businessman.[8] In this transaction, he purchased subordinated debt -- and that is precisely what he received. That debt was made part of Midwest Federal's regulatory capital. As a result, plaintiff is estopped from rescinding the purchase of the debentures and escaping his subordinated status.

As a second line of attack, plaintiff seeks rescission of the transaction under the Minnesota Blue Sky law, Minnesota Statutes, §§ 80A.01 and 80A.23. Equitable principles apply in a purchaser's action. for rescission under § 80A.23. Minnesota Statutes, § 80A.23(1); Logan v. Panuska, 293 N.W.2d 359, 363 (Minn.1980); McCauley v.

---

[8]In Weis Securities, the Second Circuit rejected an argument that a lack of sophistication converts a subordinated debenture holder into a general creditor. Weis Securities, 605 F.2d at 597.

Michael. 256 N.W.2d 491, 500 (Minn.1977).

Rescission under § 80A.23 serves a dual function: it protects innocent purchasers and compels sellers to comply with securities regulations by depriving them of ill-gotten gains.[9] Note, The Minnesota Supreme Court: 1980, 65 Minn. L. Rev. 1063, 1069 (1981). Here, neither policy of § 80A.23 will be furthered by allowing rescission.

This transaction, even at this early stage of the proceeding, cannot be regarded as one conducted in the regular course of business dealings. As acknowledged at oral argument, plaintiff took a loan from Midwest Federal and immediately loaned the selfsame funds back to the institution from which he had

---

[9]But plaintiffs cannot use the Blue Sky law to save themselves from errors in business judgment; equity will not allow blind protection of purchasers. Logan, 293 N.W.2d at 363.

just secured the loan. Tr. of motion proceedings, at 19-20 (Aug. 24, 1989). These are the funds which purchased the subordinated debt. Id. See Bond v. Charlson, 374 N.W.2d 423, 430 (Minn.1985) (a defrauded purchaser is estopped from rescinding if performed with knowledge of the facts which constituted the fraud).

Plaintiff also asserts a claim for money damages on the basis of common law fraud. In response, the FSLIC seeks to have this claim dismissed as moot since plaintiff can never obtain satisfaction of a money judgment. The Court recognizes that the general rule is "[c]laims for damages or other monetary relief automatically avoid mootness, so long as the claim remains viable." 14A C. Wright & A. Miller, Federal Practice and Procedure, § 3533.3 (1984).

As demonstrated above, plaintiff is a subordinated creditor. The FHLBB has already determined the subordinated debentures are worthless because Midwest Federal's assets were insufficient to satisfy general creditor liabilities. FHLBB Resolution 89-1388 at 3. Thus, the FSLIC argues, even if plaintiff were to succeed on his subordinate debt claims, his victory would be unavailing; his claim is not viable.

At least three courts have ruled that if the receiver would never have any assets with which to satisfy a judgment, a damages action is properly dismissed on prudential grounds. Triland Holdings & Co. v. Sunbelt Serv. Corp., 884 F.2d 205, 208 (5th Cir.1989); Federal Sav. and Loan Ins. Corp. v. Locke, 718 F.Supp. 573, 587 (W.D.Tex.1989); Stevenson v. Federal Sav. and Loan Ins. Corp., 716 F.Supp. 981, 982

(S.D.Tex.1989). This Court adopts this rule.

Accordingly, in order to conserve the limited resources of the judiciary, this Court declines to adjudicate plaintiff's futile damages claim.

Plaintiff, citing Rule 56(f), Fed.R.Civ.P., also asserts defendant's summary judgment motion to be premature, claiming a need to conduct further discovery. The request for additional discovery is wholly general and offers no specifics as to what discovery is sought.[10] A court may grant a continuance

---

[10]Under the rule, one who claims a need for additional discovery must file an affidavit stating the reasons they cannot sufficiently establish the existence of a material factual dispute. Beckers v. International Snowmobile Indus. Ass'n, 581 F.2d 1308, 1311 (8th Cir.1978), (citing C. Wright & A. Miller, Federal Practice and Procedure §2740), cert. denied, 440 U.S. 986 (1979). See also Burlington Coat Factory v. Esprit De Corp., 769 F.2d 919, 926 (2d Cir.1985) (affidavit under Rule 56(f) must explain what facts are sought, how they are to be

in accordance with Rule 56(f), Fed.R.Civ.P. United States v. Light, 766 F.2d 394, 398 (8th Cir.1985). That rule, however, does not require a court to order further discovery prior to summary judgment. Id. at 397.

The Court finds no reason for further discovery or for delay here. At oral argument, plaintiff's counsel indicated the proposed discovery pertained to plaintiff's subjective knowledge concerning whether his investment would be used to enable Midwest Federal to comply with regulatory capital

---

obtained, how those facts are expected to create an issue of material fact, what efforts the affiant has made to obtain the facts, an why the efforts have been unsuccessful; failure to file such an affidavit is enough to reject a claim of inadequate discovery), aff'd in part, rev'd inpart, 769 F2d 919 (2d Cir.1985).

requirements.[11] Tr. of motion proceedings, at 28-29 (Aug. 24, 1989). The Weis Securities discussion of subjective knowledge, above, makes clear that the proposed discovery would be superfluous.

Plaintiff's final contention is that the purchase and assumption transaction was flawed. This entire argument is premised upon a finding that plaintiff is able to rescind the subordination agreement and occupy the same posture as Midwest Federal's general creditors. The Court has found that plaintiff is not entitled to rescind his agreement and remains a subordinated creditor of Midwest Federal. Thus, since plaintiff is not to be treated as a general creditor, he is not entitled to

---

[11]The Court finds it difficult to understand why one would need to conduct discovery to discern his own subjective state of mind.

participate ratably in the distribution of Midwest Federal's assets pursuant to 12 U.S.C. § 1729.

Accordingly, IT IS ORDERED that:

1. The motion of defendant FSLIC as receiver for Midwest Federal to dismiss Counts III, IV, V, VI, and VII of the third amended complaint is granted.

2. In light of this Court's dismissal of all claims against the FSLIC (now RTC), the remaining parties are directed to submit letters to this Court within ten days of this order addressing whether to remand this action to the state court from whence it came.

APPENDIX E

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION
Civil No. 4-89-558

Stephen Adams	)	
	)	
v.	)	ORDER
	)	
Federal Deposit Ins. Corp.	)	

This matter is before the Court on defendant's motion to dismiss or, alternatively, for summary judgment. Defendant's motion is granted. Oral arguments were heard January 12, 1990.

This action arises out of plaintiff's purchase of $2.5 million in subordinated debentures from Midwest Federal. The relevant facts concerning this event are set forth in this Court's February 9, 1990, order in the related case of Adams v. Resolution Trust Corp., et al., Civil No. 4-89-330 (D.Minn). In that order, this Court dismissed plaintiff's claims

against the Resolution Trust Corp. In particular, the Court found plaintiff is not entitled to rescission of the subordinated debenture purchase and therefore retains his subordinated status.

The gravamen of plaintiff's complaint in this case is that the purchase and assumption transaction was flawed and he, as a general creditor, is entitled to ratable distribution. As was acknowledged at oral argument, plaintiff's entire case is premised on a finding that he is entitled to ratable distribution. Tr. of motion proceedings at 20 (Jan. 12, 1990). Because this Court, in Adams v. Resolution Trust Corp., determined plaintiff is not a general creditor entitled to ratable distribution, this action must be dismissed. Accordingly, based on the

files, records, and proceedings herein, IT IS ORDERED that:

Defendant's motion to dismiss is granted and this matter is dismissed with prejudice.

Dated: February 23rd, 1990

/s/ James M. Rosenbaum
JAMES M. ROSENBAUM
United States District Judge

APPENDIX F

STATUES RELIED UPON

		Page
I.	12 U.S.C. § 63	102a
II.	12 U.S.C. § 1441a	103a
III.	12 U.S.C. § 1729	105a

REGULATIONS RELIED UPON

I.	12 C.F.R. § 563.8-1 (1988)	107a
II.	12 C.F.R. § 563.13 (1989)	107a
III.	12 C.F.R. § 567.2(a) (1991)	108a

APPENDIX F

I. 12 U.S.C. § 63

The shareholders of every national banking association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares.

Repealed Pub.L. 86-230, § 7, Sept. 8, 1959, 73 Stat. 457.

II. 12 U.S.C. 1441a

Financial Institutions Reform, Recovery and Enforcement Act of 1989

* * *

(b) Resolution Trust Corporation established. (1) Establishment. (A) In general. There is hereby established a Corporation to be known as the Resolution Trust Corporation which shall be an instrumentality of the United States.

* * *

(3) Duties. The duties of the Corporation shall be to carry out a program, under the general oversight of the Oversight Board and through the federal Deposit Insurance Corporation (or any replacement authorized pursuant to subsection (m)), including:

(A) To Manage and resolve all cases involving depository institutions-

(i) the accounts of which were insured by the Federal Savings and Loan Insurance Corporation before the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [enacted Aug. 9, 1989]; and

(ii) for which a conservator or receiver--

(I) had been appointed at any time during the period beginning on January 1, 1989, and ending on the date of the enactment of such Act (including any institution described in paragraph (6)); or

(II) is appointed within the 3-year period beginning on the date of the enactment of such Act.

(B) To manage the Federal Asset Disposition Association, subject to the provisions of subsection (f)-

(C) To conduct the operations of the Corporation in a manner which--

(i) maximizes the net present value return from the sale or other disposition of institutions described in subparagraph (A) or the assets of such institutions;

(ii) minimizes the impact of such transactions on local real estate and financial markets;

(iii) makes efficient use of funds obtained from the Funding Corporation or from the Treasury;

(iv) minimizes the amount of any loss realized in the resolution of cases; and

(v) maximizes the preservation of the availability and affordability of residential real property for low- and moderate-income individuals.

* * *

(6) Successor to FSLIC as conservator or receiver. As of the date of enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [enacted Aug. 9, 1989], the Corporation shall succeed the Federal Savings and Loan Insurance Corporation as conservator or receiver with respect to any institution for which the Federal Savings and Loan Insurance Corporation was appointed conservator or receiver during the period beginning on January 1, 1989 and ending on such date of enactment.

III. Federal Savings and Loan Insurance Corporation Act, 12 U.S.C. § 1729, et seq. (excerpt)

A. 12 U.S.C. § 1729[1]

* * *

(b) Powers of corporation on default of Federal Savings and Loan Association. In the event that a Federal savings and loan association is in default, the Corporation shall be appointed as conservator or receiver and is authorized as such (1) to take over the assets of and operate such association, (2) to take such action as may be necessary to put it in a sound and solvent condition, (3) to merge it with another insured institution, (4) to organize a new Federal savings and loan association to take over its assets, or (5) to proceed to liquidate its assets in an orderly manner, whichever shall appear to be to the best interests of the insured members of the association in default; and in any event the Corporation shall pay the insurance as provided in section 405 [§ 1728 of this title] and all valid credit obligations of such association. The surrender and transfer to the Corporation of an insured account in any such association which is in default shall subrogate the Corporation with respect to such insured account, but shall not affect any right which the insured member may have in the uninsured portion of his account or any right which he may have to

---

[1]Repealed by Act August 9, 1989, P.L. 101-73, Title IV, § 407, 103 Stat. 363.

participate in the distribution of the net proceeds remaining from the disposition of the assets of such association.

REGULATIONS RELIED UPON

I. 12 C.F.R. § 563.8-1 (1989)

Issuance of subordinated debt securities

(a) General. No insured institution shall issue subordinated debt securities pursuant to this section or amend the terms of such securities unless it has obtained written approval of the Corporation. Approval of the issue under this section, in order to meet the requirements of § 561.13, may be obtained either before or after the securities and the form and manner of filing of the application are in accordance with the provisions of this section.

II. 12 C.F.R. § 563.13 (1989).

Regulatory Capital Requirement.

* * *

(b) Minimum required amount. Except as otherwise provided in this section, the minimum regulatory capital requirement for any calendar quarter (commencing with the quarter ending March 31, 1987) shall be an amount equal to the sum of an institution's liability component and contingency component minus its maturity matching credit. An institution shall not use the maturity matching credit to reduce its required amount of regulatory capital below 3 percent of total liabilities for the period from December 31, 1986, until December 31, 1989, or to reduce its required capital below 4

percent of total liabilities on or after January 1, 1990.

III. 12 C.F.R. § 567.2 (1991)

Minimum regulatory capital requirement

(a) To meet its regulatory capital requirement a savings association must satisfy each of the following capital standards;

(1) Risk-based capital requirement. (i) A savings association's minimum risk-based capital requirement shall be an amount equal to 6% of its risk-weighted assets as measured pursuant to § 567.6 of this part plus 2% of its risk-weighted assets as measured pursuant to that section.

(ii) A savings association may not use supplementary capital to satisfy this requirement in an amount greater than 100% of its core capital as defined in § 567.5 of this part.

APPENDIX G

TRANSCRIPT OF MOTION PROCEEDINGS HAD BEFORE THE HONORABLE JAMES M. ROSENBAUM

August 24, 1989
United States District Court
District of Minnesota

Page 19, Lines 18-25
Page 20, Lines 1-8

THE COURT: Well, let me go a little further here. Are you familiar with the source of the two and a half million dollars:

MR. KELLY: Yes.

THE COURT: Where is that from?

MR. KELLY: It was a bridge loan from Midwest Federal.

THE COURT: So let me get clear in my mind. Midwest Federal loaned two and a half million dollars, and that two and a half million dollars was immediately lent back for subordinated debentures.

MR. KELLY: Yes, Your Honor.

THE COURT: And less than a quarter later, there was a seven and some large change million dollar loan that was made to Mr. Adams, correct?

MR. KELLY: Correct.